industry dinosaurs

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Trade barriers helped to 'create a dislocation of foreign imports which gave us the opportunity to re-engage with our customers'

By Edward Alden in Washington and Caroline Daniel in Chicago

When President George W. Bush slapped tariffs of up to 30 per cent on steel imports last year, he announced that the goal of the measure was to "facilitate positive adjustment to competition from imports".

With the announcement last week that US Steel would buy National Steel, and the pending takeover bid for Bethlehem by International Steel Group, the controversial tariff policy appears to be on the verge of a surprising success.

The deals would create two companies that would be among the 10 largest steel producers in the world, consolidating an industry that has long been highly fragmented compared with its competitors in Europe and Asia.

Charles Bradford, president of Bradford Research, a metals consultancy, says "a monumental change is occurring" that will improve the cost-competitiveness of the integrated steel mills, which had largely been written off as corporate dinosaurs.

With three or four strong steel companies, he says, the industry will be able to drive a harder bargain in negotiations with customers, helping to sustain steel prices that were at historic lows before the tariffs.

But trade lawyers and steel market analysts are less sanguine that the deals will do anything to ease international tensions over trade in steel. In the short run, they say, the problems could even get worse.

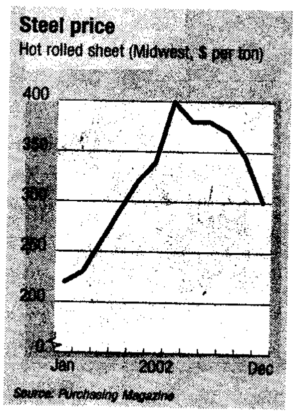
Richard Cunningham, a lawyer with Steptoe & Johnson, which represents Corus, the UK steel producer, says: "This is an industry that has always [gone], and will always go, back to the well for more import protection if the economy softens and imports are either steady or rising. You shouldn't expect the result of this will be peace in steel trade."

The Bush administration, in deciding to impose tariffs on steel imports in March, offered a shop-worn defence – that protection would give the industry "breathing room" to adjust to low-cost import competition. But past bouts of protection, including "voluntary" restraints on imports in the 1980s, have done virtually nothing to achieve that goal.

The comprehensive nature of the Bush tariff programme, however, changed the dynamic this time. In addition to the tariff protection, Bush demanded conspicuous restructuring as a quid pro quo, as well as moving aggressively to assume a portion of the onerous retirement costs for former steelworkers. A provision quietly tacked on to last year's trade bill could further provide billions of dollars to cover health care expenses for steel retirees.

Thomas Usher, chairman of US Steel, says: "Without the president's programme, it would be difficult to get where we are today. He recognised the need for stronger companies and realised that we have some companies that can compete on a worldwide basis."

Wilbur Ross, chairman of International Steel Group, which was created in February last year with the acquisition of bankrupt LTV, said of the tariffs: "It was very important. In our case we made the commitment to buying LTV a week before the Bush announcement, and we did it because it appeared to us that he would do something significant . . . We would never have made this bid without it."



Following the imposition of tariffs in March, spot prices for hot-rolled steel rose from a low of $220 per ton in January 2002 to near $400 by July. Perhaps more importantly for US steel companies, the tariffs disrupted many of the relationships between US steel buyers and foreign steel makers, forcing the customers to scramble for alternatives.

The tariffs, helped to "create a dislocation of foreign imports which gave us the opportunity to re-engage with our customers", said Mr Ross. "It was 100 per cent essential."

Both the companies and the union representing US steelworkers used the opportunity to make what promises to be radical change in the work practices governing the steel industry.

In its negotiations with ISG, the US steelworkers' union agreed to tear up a 750-page labour agreement, eliminating a host of restrictive rules that had sapped productivity. ISG in turn agreed to eliminate several layers of management bureaucracy, turning most of the day-to-day operations of its steel plants over to employees.

If such an agreement can be negotiated with US Steel and other integrated steel companies, analysts agree the result is likely to be a handful of companies that are far more competitive with low-cost imports.

The Bush administration is hoping this will make US steel producers less dependent on trade protection. But trade experts say there is little chance of that.

The most immediate effect, in contrast, is likely to be an increase in US steel capacity, resulting in more price competition between the integrated mills, the efficient non-union minimills such as Nucor, and foreign suppliers. Already steel prices have softened in the face of new import competition from developing countries and the reopening of US steel plants such as the LTV facilities.

Leo Gerard, president of the steelworkers' union, said that a key element of the deal between his workers and ISG was that the company would use the improved productivity to increase capacity and market share rather than cutting back. He said: "It's been a long time in the steel industry since a company said it wanted to get bigger, make more steel and reclaim its markets."

Mr Cunningham, the Corus lawyer, says intensified price competition will mean more demands for protection. Before the tariffs expire in March 2005, "the US industry is going to be in there asking for relief to be extended".